ASSET FINANCE

Nothing ventured, nothing gained – the appeal of asset finance to investors

Now's the time to source investment, although private equity has risks

Derek Soper

Asset finance companies that require additional funding will probably be considering the desirability and feasibility of attracting external investment. If so, they will have to decide whether it is better to own a smaller slice of a potentially larger pie, or lack funds and slow down their business while continuing to own a large share of the business.

The asset finance industry appeals to investors because of its regular and predictable cash flows, strong cash generation, and the availability of assets to serve as collateral. There is often also, of course, the opportunity to leverage the customer base by offering additional value-added products and services.

Many equipment-related companies are cyclical, and this is an important consideration for opportunistic investors. They may look to make their investment at the bottom of a cycle and hope to exit near the top. This should be borne in mind in the context of the economic climate and new business trends in the asset finance industry.

Smaller asset finance companies provide the opportunity for investors to consider a strategy of expansion and possible consolidation. However, it has to be perceived by the investor that there are considerable opportunities for the company to grow.

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The possibility of residual value exposure might be a concern, but investors are likely to be reassured if the company has in-depth asset knowledge and risk management expertise, or has acquired it by means of a quality outsourcing arrangement.

The private equity and venture capital industries have a proven track record of contributing to economic growth and job creation. The industry provides a vital source of investment to companies at all stages of development.

Funding can be sought for a variety of reasons: to fund start-ups and companies at an early stage of development that have perceived long-term growth potential; to develop new products, services and technologies; to expand working capital; to make acquisitions; or to strengthen a balance sheet.

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An important part of investors' strategy might be to leverage investments by supplementing the equity investment with debt which can be repaid over time. Debt providers will be looking for strong asset backing, or significant opportunities to generate cash. An asset finance company will have to show that it has a strong, or potentially strong, competitive ranking in the market.

Management

In order to attract investment the asset finance company must have high-quality management. It must offer the investor the possibility of a high return on its financial outlay, and the investor must be able to see a clear exit strategy.

Investors invest in people – people who have run, or are likely to run, successful businesses. They look for a high-quality, experienced and ambitious management team with a realistic plan to grow the business. A capable, committed and balanced management team brings significant credibility to the company.

The prospects for decent returns, and the risks associated with achieving the investor's goal, are critical factors. In common with the company's management, investors have a vested interest in the company's success – growth, profitability and increased value. Investors must be assured that the company will generate sustainable and predictable cash flow and, if not already profitable, will be in the black in the short term.

The non-financial input by investors is also very important, such as guidance on strategy and operations, and the ability to tap into their specialist experience of assisting companies at a time of rapid development and growth. The level of support may be 'hands-on' or 'hands-off', or somewhere between these two extremes.

The investor almost certainly will require a seat on the board, usually as a non-executive director, or even as chairman.

Investors focus on the prospect of a significant financial gain. The potential exit value of a company is a vital part of the investors' thinking. They will be keen to know where the probable exit route will lie even before the investment has been made. The company's management should not assume that their exit will coincide with that of their investor.

Most exits are realised through a trade sale to another company, which often brings a higher valuation than a full stock market quotation. This is because the acquirer needs the company to supplement its business activities. The exit may be by re-financing the investment by another institution. It could be by seeking a listing of the shares on an exchange. Or, it could be by a management buyout.

The exit strategy must be underpinned by a quality book, and the company must be professionally managed with efficient systems. An investor will want an ongoing sustainable source of funding to be available in the immediate post-exit years.

Raising equity finance is demanding, costly and time-consuming. The company's business may suffer because significant time will need to be devoted to securing the deal. Potential investors will closely scrutinise the company's past, current and prospective performance and its management. It may be beneficial to approach potential investors through a professional adviser who has previously worked with the firms, and often, more importantly, with some or all of the management team.

Investment deals can fall at the last hurdle. This may be because there is a failure to agree a price or other important terms. Or, the company's trading performance may have declined markedly during the negotiating process. Or, in recent times, due to the lack of confidence in the market.

The rewards for the asset finance company and the investor are directly linked to the value that is created. It is in the interests of both parties to work in partnership to strive for mutual success.

The author is chairman of The Alta Group, 'Advisors to the Asset Finance Industry'

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